UNITED STATES OF AMERICA
DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
OFFICE OF ADMINISTRATIVE LAW JUDGES

In The Matter of:

LONNIE A. GARVIN, JR.

Respondent.

HUDALJ 90-1415-DB
HUDALJ 90-1506-DB
Decided: January 11, 1991

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For the Government

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For the Respondents

Before: WILLIAM C. CREGAR
Administrative Law Judge

INITIAL DECISION AND ORDER

Introduction

Respondent, Lonnie Garvin, Jr., appeals a suspension and a proposed debarment issued by the Assistant Secretary for Housing of the U.S. Department of Housing and Urban Development ("HUD" or "the Department").[1] HUD proposes that Mr. Garvin[2] be debarred from further participation in primary covered transactions and lower-tier covered transactions (*see* 24 CFR 24.110(a)(1)) as either a participant or principal throughout the Executive Branch of the Federal Government, and from participating in procurement contracts with HUD, for an indefinite period commencing on June 19, 1989, the date a Limited Denial of Participation ("LDP") was imposed on him. Mr. Garvin has been suspended from participation in primary covered transactions and lower tier covered transactions throughout the Executive Branch of the Federal Government and from participation in procurement contracts with HUD pending the outcome of the debarment proceeding.

A hearing on the appeal was held in Charleston, South Carolina, on August 13-14, 1990. The Department filed its post-hearing brief on October 10, 1990, and Mr. Garvin filed his reply brief on October 25, 1990.

The issues presented in this proceeding are essentially the same as those in the related case of *In Re Robert Gordon Darby,* HUDALJ 89-1373-DB (LDP), HUDALJ 89-1387-DB (April 13, 1990)("*Darby*"). The parties stipulated to the admission of the entire *Darby* record into the record of this proceeding and incorporated the arguments made in *Darby* into their the post-hearing briefs.

The *Darby* Decision

Summary of Pertinent Factual Findings Made in the *Darby* Decision

This proceeding, and the related proceeding in *Darby*, involve the execution of a plan, originated by Mr. Garvin, to use the existing HUD/Federal Housing Administration ("FHA") single family mortgage insurance program (12

[1]The suspension was issued on June 13, 1990. The proposed debarment, originally issued on October 25, 1989, was amended on January 29, 1990.

[2]At the hearing the parties agreed that Mr. Garvin's affiliates, as identified in the Department's Complaint, were not before this tribunal. *See* Garvin Tr. Vol. II pp. 4, 5. (Where citation is made in this decision to the transcript or the exhibits admitted into evidence in *Darby*, the citation is preceded by the word "Darby". Where citation is made to the transcript or the exhibits admitted into evidence in this proceeding, the citation is preceded by the word "Garvin".)

U.S.C. 1709(b)) to finance the construction of rental units on existing lots.

Mr. Garvin, a South Carolina mortgage banker, has extensive experience with HUD programs, and has a reputation in the HUD Columbia Office of being an extremely knowledgeable and trustworthy mortgagee. (Darby Tr. pp. 408, 410, 587, 588). He originated the plan in early 1981. At that time the real estate market in South Carolina was depressed, there was little single family or multifamily development activity due to high interest rates, and there was a severe shortage of rental housing. The central feature of the plan involved the payoff of construction loans on rental units using proceeds from single family mortgages which were obtained on the rental units and which were insured by HUD/FHA. Once the units were constructed, they would be rented. Since the rents could not be set high enough to offset the debt service resulting from the high interest rates in effect at that time, the plan envisioned the use of a syndicate to cover the anticipated period of negative cash flow. The syndicate would own the property and cover the operating deficits in return for tax write-offs for its limited partner investors. The plan was based on the assumptions that: 1) the high inflation rate would continue to drive up rents, but the rate would come down in four or five years, and 2) rents would be driven up during this four or five year period. At the end of this period the rental properties could be sold or refinanced. Accordingly, the units were designed for resale as single family homes. (Darby Tr. pp. 71, 73, 224, 225, 395, 451, 581, 657, 658-661, 808, 812).

Mr. Garvin faced statutory and regulatory limitations which restricted use of the single family mortgage insurance program for extensive investment purposes. These were: 1) restrictions on the amount HUD could insure, *i.e.,* minimum investment requirements,[3] and 2) limitations on the number of mortgages issued to a single borrower, the so called Rule of Seven.[4] Both of these restrictions were designed to limit defaults and protect the value of property placed in the HUD inventory as a result of defaults. The requirement for a minimum investment acts to reduce the amount of debt service, and gives the borrower a greater stake in the property. The restriction on the number of single family units held by the same borrower is designed to prevent mass defaults and to reduce the risk of depressed real estate prices. The latter risk is the result of mass defaults. An increased number of foreclosed properties on the market in a given location will make them more difficult to sell, thereby increasing management costs. (Darby Tr. pp. 39, 277).

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[3] *See* 12 U.S.C. Sec. 1709(b).

[4] *See* HUD HB 4155.1, Para. 1-14(g) (April 1977), Darby Gov't. Ex. G-153(a). *See also* 24 CFR 203.42.

In mid-1981, Henry Granat, the Deputy Director for Housing Development of the HUD Columbia Office, and Robert DesChamps, the Chief of the Mortgage Credit Branch of that office, told Mr. Garvin that the Rule of Seven would be satisfied by dividing up the units so that any particular borrower would have no more than seven units at the time of loan closing. (Darby Tr. p. 663).

The financing plan developed by Mr. Garvin entailed the use of individuals who would be given title to the properties prior to closing and who would, shortly thereafter, transfer the properties to a syndicate. The individuals selected for this purpose were the employees of Mid-South, the HUD approved mortgagee of which Mr. Garvin was president. (Darby Tr. pp. 652, 653). The first implementation of the plan was to be a 30-unit duplex called Plantation Ridge. Mid-South prepared applications for firm commitments for mortgage insurance using a HUD Standard Form 92900.1. (Darby Tr. 668, 669). The applications were signed by the Mid-South employees. (Darby Gov't. Exs. G-38 (d) to G-39 (d)). The applications were completed to reflect not only compliance with the Rule of Seven, but also, *inter alia,* that the purpose of the loan was "refinance". "Refinances" as opposed to "purchases" did not require any minimum investment. Moreover, under HUD rules existing at that time, if in a "refinance" the amount of the new loan exceeded the original mortgage, the borrower was permitted to "pull out" the excess cash. Since the loan proceeds were to be used to refinance and pay off the construction loans, and construction lenders typically loan less than the value of the completed home, each transaction could result in a surplus which could be "pulled out". (Darby Tr. pp. 98, 675, 678; Darby Gov't. Ex. G-138).

By November 1981, the Plantation Ridge applications had been prepared. Mr. Garvin met again with Messrs. Granat and DesChamps and told them most, but not all, of the elements of the plan. (Darby Tr. pp. 431, 432, 452-55, 468, 469). At Mr. Granat's direction, Mr. DesChamps telephoned HUD Headquarters in Washington, D.C. and, in the presence of Mr. Garvin, spoke with Ruth Studer, a HUD employee in the Headquarters' Single Family Division Mortgage Credit Section. She was one of two staff employees responsible for answering questions from the field relating to the single family mortgage credit program. (Darby Tr. pp. 59, 67). Based upon Mr. DesChamps' description of the plan, she stated that HUD program requirements would not be violated.

The HUD Columbia Office approved the firm commitment applications for Plantation Ridge, and the steps necessary for issuance of the mortgage insurance proceeded. (Darby Tr. pp. 681, 709). Implementation of the plan

required the "borrowers", *i.e,* Mid-South employees, to have title at the time of closing. Accordingly, prior to closing, Mr. Garvin's development company transferred title of the units to the individual Mid-South employees. After closing, the employees transferred title to a syndicated limited partnership which owned and operated the units as Plantation Ridge Development. (Darby Tr. p. 681).

Between 1981 and 1984, Mid-South processed approximately 1,050 Section 203(b) applications through the HUD Columbia Office using the Plantation Ridge prototype.[5] Over 1,600 units were developed. (Darby Tr. pp. 704, 705). The applications included those Mid-South processed for Mr. Darby, a South Carolina real estate developer.

While HUD employees in Columbia knew of and had approved the financing plan, it was not until some point in early 1983 that they became conscious of the extent and location of the rental projects being financed with the Mid-South financing method. (Darby Tr. pp. 383, 466). The HUD Columbia Office continued to approve the Mid-South applications. Ms. Studer was called once more by Mr. DesChamps in March 1983. Again, she found no aspect of the plan improper. (Darby Tr. p. 599; Darby Gov't. Ex. G-111). Responding to concerns raised by his employees and another builder, the head of the HUD Columbia Office, Franklin H. Corley, had his staff prepare a memorandum summarizing the Mid-South financing method, which, in the Spring of 1983, was sent to Philip Abrams, the Acting Assistant Secretary for Housing/FHA Commissioner. Mr. Garvin, at the request of the HUD Columbia Office, provided that office with information regarding the number of units for which commitments were issued together with their location. (Darby Tr. pp. 373, 379, 380, 381-83). The memorandum sent by the HUD Columbia Office did not reflect that the financing arrangement was a *fait accompli*. Rather, it referred to it as a "proposal". (Darby Gov't. Ex. G-112). As a result, Mr. Abrams' reply, although stating that the "proposal" was unacceptable, did not require any corrective

[5]Mr. Garvin stated in his response to the Department's request for admissions that between 1981 and 1985, he, as President of Mid-South "originated, processed and closed, or caused to be originated, processed and closed, the loans on approximately 1,072 FHA-insured single family mortgages...using the same "financing plan" identified in [the *Darby* Decision]...." *See* Garvin Gov't. Ex. H-41; Garvin Tr. Vol. I p. 11.

action. (Darby Gov't. Ex. G-114). Upon receipt of the reply, the HUD Columbia Office stopped the approval of new applications, but continued to process and approve firm commitments for 53 conditional commitments already issued to Mid-South. (Darby Tr. pp. 706, 776; Darby Gov't. Ex. 93, p. 9).

By 1986, the economic environment was totally unlike that projected by Mr. Garvin when he originated the plan. Messrs. Darby and Garvin were faced with lower rents and destruction of the local rental market. Tenants left and the drop in the rate of inflation adversely affected the resale value of the units. As a result, Messrs. Darby and Garvin were faced with a worsening cash flow with no end in sight. U.S. Shelter, the parent company of Mid-South, was also experiencing financial difficulties. Although it had funded the operating deficits for the Mid-South projects after the corporate general partners of the projects had stopped doing so, it advised Mr. Garvin when the loans were still current that it might not be able to continue doing so. (Darby Gov't. Ex. G-93, p. 2; Darby Tr. pp. 515, 782, 783). In the Spring of 1986, U.S. Shelter went into default and, thereafter, requested HUD to accept an assignment of the single family mortgages. (Darby R. Ex. XX, pp. 3, 5, 9-16). HUD refused on legal and policy grounds.

The enormous potential financial loss resulting from default and foreclosure caused Mr. Garvin and Mr. Darby to seek some way of reaching an accommodation with HUD. The workout negotiations, which were undertaken by Messrs. Darby and Garvin at personal expense, terminated in September 1988 without resulting in any accommodation. (Darby Tr. pp. 528-30, 568, 780, 835; Darby Gov't. Ex. G-144, pp. 2, 3, 9; Darby R. Ex. XX, p. 37). In October 1988, Messrs. Darby and Garvin offered to tender deeds in lieu of foreclosure on certain properties. Ultimately, 1,600 properties were deeded to HUD for the amount of the outstanding debt, the foreclosure actions were dropped, and the applicant "borrowers" were released from personal liability on the mortgage notes. (Darby Tr. pp. 536, 717, 841). As of the date of the *Darby* hearing, total claims in the amount of $6,475,466.22 were paid by HUD for these properties (Darby Tr. p. 340; Darby Gov't. Ex. G-155), and the properties remained in the HUD inventory. The properties have been maintained by HUD, a task that, as of the date of the *Darby* hearing, had amounted to an additional expense of $142,023.67. (Darby Tr. p. 341; Darby Gov't. Ex. G-155). The total "loss" on the properties as of the date of the *Darby* hearing was $6,617,489.89. (Darby Gov't. Ex. G-155). However, since the properties should eventually be sold, the actual loss (or profit) is unknown.[6]

[6]As noted in the Pretrial Order dated August 3, 1990, the Department withdrew from consideration as an issue in this proceeding its contention "that the actual losses which [it] may have suffered are to be

A report, issued as a result of a HUD audit of the Mid-South loan transactions, concluded that there was no wrongdoing on the part of either Mr. Garvin or Mr. Darby, and that neither the HUD Columbia Office nor HUD Headquarters had been misled. (Darby Tr. pp. 126, 516-518; Darby Gov't. Ex. G-93, pp. 2, 3). Moreover, after initiation of an Inspector General investigation of the Mid-South transactions in 1988, the U.S. Attorney declined to bring criminal prosecutions, stating that there was no evidence of an intent to commit a crime. Rather, he determined that the intent was to take advantage of a financing situation for projects not feasible for conventional financing and that HUD officials had permitted this. (Darby Tr. pp. 294, 295, Darby R. Ex. NN). James Nistler, the former Deputy Assistant Secretary for Single Family Housing, testified that HUD found no evidence of fraud, deception, deceit or intentional false statements (Darby Tr. pp. 524, 535), or that the program was designed to fail. (Darby Tr. p. 525). He also believed that both the HUD Columbia and Headquarters' offices had been sufficiently aware of the relevant facts and had approved what had been done.

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considered as a factor in determining the length of any debarment." Despite this Order, the Department has compared the amount of "loss" which existed as of the date of the *Darby* hearing with the actual loss suffered by the Government in another case, *In re First Security Mortgage Company,* HUDALJ 90-137-MR (Aug. 24, 1990). By virtue of that comparison, the Department argues that as in *First Security* where this tribunal affirmed a proposed indefinite withdrawal of a HUD/FHA-approved mortgagee, this tribunal should impose upon Mr. Garvin an indefinite period of debarment. *See* Government's Post Hearing Brief at 17-18. As stated in the Pretrial Order, the amount of any such losses suffered by HUD is not a factor in the assessment of any sanction against Mr. Garvin and I have not considered it.

When Mr. Nistler left HUD in March 1989, he was unaware of any sanctions being considered against Mr. Garvin or Mr. Darby. According to Mr. Nistler, by then "...we had already statutorily changed the programs to where in fact it couldn't be done again." (Darby Tr. p. 540). Specifically, the "investor program" for single family mortgages has been eliminated. (Darby Tr. pp. 39, 278). Cash can no longer be "pulled out" of transactions. (Darby Tr. p. 98; Darby Gov't. Ex. G-138).

Summary of Conclusions Reached in the *Darby* Decision

It was held in the *Darby* Decision that, despite the complicity of certain components of the Department, the Mid-South financing program was a sham which improperly circumvented the Rule of Seven. Because of preclusion by the Rule of Seven, neither Mr. Darby nor the entities in which he had an interest could apply for financing for more than seven units in their own names. Accordingly, Mr. Darby used the Mid-South financing plan pursuant to which the applicants/borrowers, in their individual capacities but on his behalf, temporarily held title to no more than seven properties at one time.

The *Darby* Decision also held that in order to effectuate a sham, title was temporarily passed to the applicants/borrowers so that the Rule of Seven could be circumvented. Moreover, it was held that the transactions were falsely characterized on the applications as "refinances" in order to avoid the minimum investment requirements. The characterization was found to be false because: 1) the transactions constituted two separate sales rather than one refinance, and 2) an applicant cannot apply in his own name to refinance a construction loan on behalf of another. By characterizing each transaction as a "refinance" rather than a "sale" on the applications, it was concluded that Mr. Darby was able to obtain financing to which he was not entitled, including amounts obtained by avoiding the minimum investment requirements, and amounts obtained in the form of a cash surplus. Finally, it was held that effectuation of the Mid-South program under the single family mortgage insurance program necessarily avoided the more stringent requirements of the multifamily mortgage insurance program.

Accordingly, it was concluded that Mr. Darby's use of the Mid-South financing program constituted grounds for a debarment, as well as an LDP. In so concluding, it was found that Mr. Darby had willfully and materially violated statutory and regulatory provisions and program requirements (*see* 24 CFR 305(b) and (f)), and that the false statements made on the applications for FHA insurance reflected adversely on his present responsibility (*see* 24 CFR 305(d)). It was concluded, however, that the Department failed to prove by preponderant

evidence that Mr. Darby's defaults were grounds for debarment since he had made good-faith efforts to negotiate a workout with HUD to avoid foreclosure. The *Darby* Decision also rejected Mr. Darby's argument that the doctrine of equitable estoppel provided a defense to the imposition of a debarment. It was held that Mr. Darby's reliance on the representations made by HUD regarding the permissibility of the Mid-South financing program was unreasonable since he knew, or should have known, that the financing program violated the spirit and intent of the single family program, the Rule of Seven, and the minimum investment requirements.

In connection with its assessment of the appropriate period of Mr. Darby's debarment, it was found that mitigating circumstances militated against imposition of a debarment for an indefinite period. In that regard, the *Darby* Decision stated that the lack of criminal intent, including an intent to defraud the government, militated against a period of debarment for more than three years. Other mitigating circumstances which were considered were that: 1) Mr. Garvin, rather than Mr. Darby, conceived the Mid-South financing program, 2) the program was not designed to fail, 3) although Mr. Darby was able to "pull out" excess mortgage proceeds, his corporation and the syndicate covered substantial operating deficits for several years, which essentially had the effect of "subsidizing" the rental property, and 4) it was the fact that Mr. Darby's and Mr. Garvin's market assumptions were not realized which prevented Mr. Darby from ultimately selling the properties as single family housing and which led to the defaults.

The most important mitigating factor, however, was the extent to which Mr. Darby genuinely cooperated with HUD to try to work out his financial dilemma and avoid foreclosure. That cooperation was further enhanced by the undisputed evidence of his reputation for truth and veracity among reputable lenders in the community and of his exemplary performance as a builder and manager of housing projects. It was also found that Mr. Darby appeared to genuinely regret the situation in which he placed himself. Finally, the passage of time was considered to weigh in favor of mitigation. Mr. Darby's acts had taken place in 1982 and 1983, the LDP had been issued and debarment had been proposed in 1989, and by the time the LDP had been issued and the debarment had been proposed, the programs had been changed by statute to eliminate use of the single family mortgage program for investment purposes.

Accordingly, it was found that Mr. Darby should be debarred for a period of 18 months, beginning on June 19, 1989, the date on which the LDP was imposed. That period of debarment was considered to be a serious sanction,

commensurate with the seriousness of his acts.

Findings of Fact

The issues presented here are, for the most part, identical to those presented in *Darby*. The parties stipulated to the admission of the record in *Darby* into the record of this proceeding. Accordingly, the findings of fact set forth in the *Darby* Decision at 3-23, are incorporated by reference. The following additional findings of fact are necessitated by issues raised with respect to Mr. Garvin and which were not set forth in the *Darby* Decision.

HUD-1 Settlement Statements

A HUD-1 Settlement Statement is included in the package of documents submitted to HUD in order to obtain a mortgage insurance commitment. (Garvin Tr. Vol. I p. 54). It is prepared prior to a real estate closing to summarize the terms of the transaction, and to reflect the charges that have been paid by the borrower and the seller. (Garvin Tr. Vol. I pp. 18, 54-56, 60-62).

The HUD-1 is prepared by the settlement agent who conducts the closing. That agent is typically an attorney. It is prepared based on information provided by the mortgage lender to the settlement attorney through a letter of instructions. (Garvin Tr. Vol. I. pp. 19, 64, 67).

There is no HUD requirement that the HUD-1 be completed in a particular manner. Moreover, settlement attorneys prepare the Statements in a variety of ways. There is no HUD requirement that the HUD-1 be completed to reflect either a purchase or a refinance.[7] (Garvin Tr. Vol. I pp. 71, 79, 83-84).

Mr. Garvin submitted 36 loan applications to HUD for which either he or a general partnership (in which he was a partner) was the borrower. (Garvin Gov't.

[7]The only specific statute relied upon by the Department in this regard is the Real Estate Settlement Procedures Act of 1974, as amended, 12 U.S.C. Sec. 2601 *et seq.* That statute merely requires that in all transactions involving federally related mortgage loans, the standard form prescribed for the statement of settlement costs "shall conspicuously and clearly itemize all charges imposed upon the borrower and all charges imposed upon the seller in connection with the settlement...." *See* 12 U.S.C. Sec. 2603(a). It does not mandate that the form be completed in a specific manner or that it reflect a purchase or a refinance.

Exs. H-1(d) through H-36(d)). In conjunction with the closings on those transactions, 36 HUD-1s were prepared. (Garvin Gov't. Exs. H-1(e) through H-36(e)).

Mr. Garvin's Character and Reputation

Mr. Garvin's personal and business character and reputation were strongly vouched for by two witnesses at the hearing.[8] One such witness was Gordon Parrott, a

banker in Aiken, South Carolina. Mr. Parrott has been a banker for approximately 28
years, and is currently with Aiken County National Bank, which he founded with seven other individuals in 1988. Mr. Parrott has known Mr. Garvin both personally and professionally for approximately 28 years. From 1962 to 1985 Mr. Parrott, as an employee and officer of Farmer's Merchants Bank in Aiken (which in 1982 was purchased by C & S Bank), made hundreds of personal and

[8]The testimony given by a witness at the *Darby* hearing concerning Mr. Garvin's character and reputation is consistent with that given by the two character witnesses who testified during Mr. Garvin's hearing. That witness, Joseph C. Reynolds, is a mortgage banker and has known Mr. Garvin since 1968. Mr. Garvin is a business competitor of Mr. Reynolds, but has also borrowed between $2 and $5 million from the company which employs Mr. Reynolds. Mr. Reynolds testified that based on his own personal dealings with Mr. Garvin, as well as Mr. Garvin's reputation in the community, he has had no problems with Mr. Garvin's truthfulness, veracity, integrity, honesty and professional responsibility. (Darby Tr. pp. 636-38).

business bank loans to Mr. Garvin, which, in the aggregate, amounted to hundreds of millions of dollars. Mr. Parrott testified that he never had any problem approving these loans, and that Mr. Garvin never defaulted on any of these loans. Those loans included construction loans made from 1981 to 1985, which were paid in full by Mr. Garvin with FHA loan proceeds. (Garvin Tr. Vol. II pp. 23-28, 42).

In 1985, Mr. Parrott left Aiken, and became president of Farmer's Bank in Greensboro, Georgia. Mr. Parrott worked in Greensboro from 1985 to 1988, and during that time made loans to Mr. Garvin out of his own personal funds in connection with a business venture called River Bluff. Since returning to Aiken in 1988, Mr. Parrott, through Aiken County National Bank, has continued to loan Mr. Garvin money for personal and business purposes. For personal use, Mr. Parrott has loaned Mr. Garvin up to $50,000 on an unsecured basis. In connection with Mr. Garvin's businesses, Mr. Parrott has made 20 to 25 bank loans to Mr. Garvin, totalling more than $1.5 million. (Garvin Tr. Vol. II pp. 28, 29, 37, 38).

Mr. Parrott is generally familiar with the charges brought by HUD against Mr. Garvin. His familiarity resulted from the publicity which Mr. Garvin's problems have received, as well as conversations he had with Mr. Garvin before the charges were reported in the newspapers. He also learned of Mr. Garvin's problems from a member of the Board of Directors of C & S Bank. That individual had ties to U.S. Shelter. Since learning of the charges, Mr. Parrott has loaned Mr. Garvin money, and at the time of the hearing, was processing an additional five loans amounting to more than $150,000. (Garvin Tr. pp. 32, 33, 44).

Mr. Parrott was aware that some defaults had occurred. He lacks detailed knowledge of the Mid-South financing program. He is also unaware of the identity of the defaulting parties and the number of loans that have gone into default. (Garvin Tr. Vol. II pp. 38, 39, 42-48). Mr. Parrott is aware that Aiken County National Bank's credit file concerning Mr. Garvin's loan history indicates that Mr. Garvin "could have some legal responsibility in paying back these loans with FHA, as a general partner", and that, therefore, there was a "potential" for default. However, this file does not reflect the number of loans involved. (Garvin Tr. Vol. II pp. 46-48). With regard to Aiken County National Bank having lent money to Mr. Garvin after having learned of Mr. Garvin's potential liability on the

defaulted loans as a general partner, Mr. Parrott believes that despite the bank's knowledge that there was a "big risk", it approved these loans because of Mr. Garvin's honesty and integrity. He stated: "we felt like...each credit request...was a solid credit request and we'd get our money back." (Garvin Tr. Vol. II p. 47). After discussing the "dollar figure" of the potential liability with Mr. Garvin, he did not think that Mr. Garvin "would have the financial capacity to meet it", and knew in the event Mr. Garvin were required to do so, any loans he made Mr. Garvin would then go into default. Despite this risk he lent Mr. Garvin more money. He states as his reason: "[b]ecause of Mr. Garvin." (Garvin Tr. Vol. II p. 48).[9]

Mr. Parrott regards Mr. Garvin "as a man of the highest integrity", has "always had confidence in what he said", and has "respected his professional ability." (Garvin Tr. Vol. II pp. 33, 34). He states that Mr. Garvin has "always been above board", and that if Mr. Garvin was not responsible, his bank "wouldn't be lending to him in the volume and the number of loans and in [this] type [of risky] transaction . . . ." (Garvin Tr. Vol. II p. 34).

The other witness who vouched for Mr. Garvin's character and reputation was Horace Edward Curry, Jr. Mr. Curry is currently a real estate agent and broker specializing in property management, primarily in the tri-county area around Charleston, South Carolina. His involvement in the real estate business began nearly 30 years ago, when he began a single-family residential construction business. He has approximately 23 years of experience as a real estate agent and broker, and has known Mr. Garvin for that same amount of time.

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[9]I find that Mr. Parrott testified with forthrightness and candor and, therefore, have credited his testimony. Moreover, it is noteworthy that the Department does not seek to discredit Mr. Parrott's testimony. Rather, it argues that "Parrott's testimony with regard to his reliance on Garvin to tell all, and Garvin's failure to tell all must lead this Court to a new inquiry as to how much Garvin really did tell the HUD employees." *See* Government's Post Hearing Brief at 13. According to the Department, that testimony, coupled with other evidence in the case, demonstrates that "Garvin maintained a practice of less than full disclosure and continues to maintain that practice with his own banker." *Id.* at 14.

Mr. Parrott's testimony does not alter the conclusion reached in the *Darby* Decision and incorporated into this Initial Decision and Order, that "[w]hile use of the Mid-South financing program was improper and involved making false statements on the applications, there is no evidence of any intent to deceive the Department; most of the relevant facts were indeed disclosed to the HUD Columbia Office and a Headquarters employee." *See Darby* Decision at 35. Here, Mr. Garvin made the critical disclosure to Mr. Parrott that there were potential defaults, which, if realized, would prevent Mr. Garvin from repaying the loans he had made with Mr. Parrott. Accordingly, the disclosures made by Mr. Garvin to Mr. Parrott, or the purported lack thereof, do not raise the negative inference, suggested by the Department, that Mr. Garvin deceived HUD employees.

(Garvin Tr. Vol. II pp. 6-8).

Mr. Curry was first introduced to Mr. Garvin in the late 1960's when the mortgage company with which Mr. Garvin was associated lent Mr. Curry money for single family construction projects. Mr. Curry borrowed money from that company for several years, and also became more involved in multifamily housing and development. In 1982 or 1983, he and Mr. Garvin formed a partnership for the purpose of constructing townhouses in North Charleston. At this time Mr. Curry was in frequent contact with Mr. Garvin. When the partnership was formed, Mr. Curry functioned as the general partner in charge of construction. U.S. Shelter initially managed the townhouse complex, but was unsuccessful. As a result, Mr. Curry's property management company, Curry and Nester, was hired to manage the complex. (Garvin Tr. Vol. II, pp. 8-10, 13, 14).

In May 1990, Curry and Nester, Mr. Garvin and another individual formed a partnership in connection with four apartment complexes in Augusta, Georgia.[10] Since then Mr. Garvin has overseen and managed these properties. Mr. Garvin was hired under a management contract As of the date of the hearing, the properties were not producing any partnership dividends, although under Mr. Garvin's stewardship, the occupancy rate has improved. At the time the partnership was formed, Mr. Curry was familiar with the problems Mr. Garvin was having with HUD, including the failed workout attempts. Mr. Curry's familiarity with Mr. Garvin's problems was based on the publicity Mr. Garvin had received, as well as his personal contacts with Mr. Garvin. (Garvin Tr. Vol. II pp. 14-16, 20, 22, 23).

Mr. Curry furnished uncontradicted, credible testimony that: 1) if he and his partners did not have full trust in Mr. Garvin, they would not have asked Mr. Garvin to become their partner and to oversee and manage the Augusta properties, 2) Mr. Garvin has turned management of the properties around, 3) because he and his partners have total trust in Mr. Garvin and believe he is honest, they had not reviewed Mr. Garvin's books in the last five months and instead, rely on monthly reports Mr. Garvin sends them, 4) he has no reason to believe Mr. Garvin ". . .to be anything other than honest and just, with total

[10]At the time of the hearing, the final partnership arrangements had not been completed. The partners intend to refinance the existing mortgages, but as of the date of the hearing, no application had been filed to accomplish any such refinance. Moreover, Mr. Curry did not know whether the existing mortgages are FHA-insured. (Garvin Tr. Vol. II pp. 20-22). The Department, however, argues that Mr. Curry has "a strong interest in vouching for Garvin's honesty and integrity because, if Garvin's suspension and debarment are affirmed, the partnership will be prohibited from obtaining FHA-insured financing for these four projects." *See* Government's Post Hearing Brief at 12. Even if affiliation with Mr. Garvin would prevent the partnership from obtaining FHA-insured financing for its Augusta projects, there is no factual support for the Department's argument since there is no evidence that FHA-insured refinancing will be sought. The argument proffered by the Department to demonstrate Mr. Curry's bias in favor of Mr. Garvin is, therefore, speculative. Since Mr. Curry's testimony was forthright and frank, I have credited his testimony. Indeed, Mr. Curry's testimony regarding the Augusta projects is illustrative of his faith in Mr. Garvin, since Mr. Garvin was invited to join the venture even though he and the other partners knew of Mr. Garvin's unresolved problems with HUD.

integrity" and to have "business responsibility", 5) Mr. Garvin has a reputation for honesty, integrity and business responsibility in the community, 6) he is "thankful" and "proud" to be Mr. Garvin's partner, and 7) because of Mr. Garvin's business reputation and the contacts Mr. Garvin has with banks which recognize his integrity, the Augusta properties partnership was able to borrow its start-up money. (Garvin Tr. Vol. II pp. 16-18).

Mr. Garvin's Participation in the Workout Negotiations with HUD

Mr. Garvin spent approximately two years and eight months trying to obtain a workout. Foreseeing U.S. Shelter's potential financial inability to continue funding the deficits of the partnership, he began attempts at a workout in January 1986. Most of the time he was engaged in the workout negotiations, he had no income. He paid his own expenses in connection with the negotiations. (Darby Tr. pp. 718, 780-83). The former Assistant Secretary for Housing/FHA Commissioner praised both him and Mr. Darby for their efforts and cooperation in exploring various alternatives to foreclosure. (Darby R. Ex. XX, p. 37).

Discussion

1. Grounds Exist for the Debarment of Mr. Garvin

The Department asserts that Mr. Garvin's actions constitute grounds for debarment under 24 CFR 24.305(b), (d) and (f).[11] Subsection (b) provides that a debarment may be imposed for:

> [v]iolation of the terms of a public agreement or transaction so serious as to affect the integrity of an agency program, such as:
>
> * * *
>
> (3) A willful violation of a statutory or regulatory provision or

[11]The Department asserts that cause for suspension exists under 24 CFR 24.405(a)(2) and 24.305(b), (d) and (f). Section 24.405(a)(2) provides that a suspension may be imposed upon adequate evidence that a cause for debarment under section 24.305 may exist. Because both the debarment and suspension actions are brought under the same subsections of section 24.305, the conclusions reached with regard to Mr. Garvin's proposed debarment also apply to his suspension.

> requirement applicable to a pubic agreement or transaction.

Subsection (d) provides that debarment may be imposed for:

> [a]ny other cause of so serious or compelling a nature that it affects the present responsibility of a person.

This subsection goes on to enumerate specific grounds relating to violation of various statutes, regulations or agreements designed to prohibit or remedy discrimination, and statutes, regulations or agreements relating to conflicts of interest.

Subsection (f) provides that a debarment may be imposed for:

> material violation of a statutory or regulatory provision or program requirement applicable to a public agreement or transaction including applications for...insurance or guarantees, or to the performance of requirements under a...final commitment to insure or guarantee.

For the reasons set forth in the *Darby* Decision and under the heading, "Summary of Conclusions Reached in the *Darby* Decision", the Department has proved by preponderant evidence that there are grounds for the debarment of Mr. Garvin under 24 CFR 24.305(b) and (f). However, the Department has not demonstrated that subsection (d) has been violated. Subsection (d) applies to those situations where there has been a violation sufficient to demonstrate present irresponsibility which is not specifically enumerated in that subsection, but is sufficiently similar to the conduct listed in the subsection as to be comprehended by it. The violation of various statutory and regulatory requirements and "falsification" do not fall within grounds similar to conduct which relate to discrimination or conflicts of interest.[12]

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[12]As noted in *Darby*, the Secretary's designee had reversed the determination of the HUD Board of Contract Appeals in *In re Wayne C. Sellers*, HUDBCA Nos. 88-1295-DB (LDP) and 88-1305-DB (Aug. 2, 1989). *See Darby* at 30, n.45. The Board of Contract Appeals' decision applied the rule of *ejusdem generis* in holding that the general provision of subsection (d) was controlled and limited by the specific grounds for debarment which followed the general provision. The determination of the Secretary's designee was subsequently overturned and the Board of Contract Appeals' decision upheld by the U.S. District Court for the Western District of Missouri. *See Wayne C. Sellers and Sellers & Company v. Kemp,* 749 F.Supp. 1010 (W.D. Mo. 1990)(1990 U.S. Dist. LEXIS 14172).

Mr. Garvin's submission to HUD of the 36 HUD-1 Settlement Statements which identify either him or a general partnership in which he was a partner as the borrower are alleged to constitute additional grounds for Mr. Garvin's debarment. According to the Department, these HUD-1s were false. *See* Government's Post Hearing Brief at 6-9.

It has already been found in the *Darby* Decision that the applications were false and thereby constituted a basis for debarment, because, *inter alia*, they mischaracterized the transactions as refinances rather than sales. If indeed the HUD-1s are also false, they constitute additional falsifications which merely reiterate the false entries made on the applications. The HUD-1 entries and the entries made on the applications were made in conjunction with the same transactions and are consistent. Not having established that the false completion of HUD-1s violates statutory or regulatory provisions other than those already charged, the Department has not demonstrated how, under these circumstances, the entries on the HUD-1s tend to show any greater lack of present responsibility on Mr. Garvin's part. Stated somewhat differently, the Department has failed to demonstrate how, under the circumstances of this case, a greater number of false entries arising out of the same transactions, all based on the same mischaracterizations, serves to increase the severity of the sanction which would otherwise be imposed. Accordingly, I need not decide whether the submission of the 36 HUD-1s constitutes an additional ground for the debarment of Mr. Garvin, since if it did, the existence of that ground would not be a factor in the assessment of the sanction to be imposed.[13]

[13]Because the purported falsity of the HUD-1s does not, under these circumstances, increase any sanction otherwise imposed, I need not decide whether the HUD-1s were indeed "false". I do note, however, that there is no evidence, nor does the Department contend, that the amounts set forth on the forms were inconsistent with the transactions being treated as "refinances". Rather, the Department contends that the entries were false because individual entries were not placed in the "proper" location on the form, or were omitted entirely. The record does not reveal the existence of any requirement, by virtue of either statute, regulation or the terms of the HUD-1 itself, mandating that the HUD-1 be completed in a particular way or that it reflect a either a purchase or a refinance. Rather, the testimony of the

Government's expert witness, Mr. Steven Sinelsberger, a loan specialist with HUD Headquarters' Mortgage Credit Division, establishes the lack of any requirement that HUD-1s be filled out in any particular way. (Garvin Tr. Vol. I pp. 71, 79, 83-84).

2. Mitigating Circumstances Militate Against Imposition of an Indefinite Period of Debarment

Although grounds exist for the debarment of Mr. Garvin, as in the *Darby* Decision, mitigating circumstances militate against imposition of a debarment against Mr. Garvin for an indefinite period as was requested by the Department. *See* 24 CFR 24.300. Those mitigating circumstances include the lack of criminal intent, including an intent to defraud the government. This militates against a period of debarment of more than three years.[14] The other mitigating factors applicable in this proceeding, also present in *Darby*, include the following: 1) Mr. Garvin's genuine cooperation with HUD to try to work out his financial dilemma and avoid foreclosure, 2) Mr. Garvin's reputation for truth and veracity among reputable lenders and business associates in the community, 3) the passage of time since debarment was proposed, especially since the programs have been changed by statute to eliminate the "investor program" for single family mortgages, and (4) that the Mid-South financing program was not designed to fail, but, rather it was Messrs. Darby's and Garvin's incorrect market assumptions which prevented them from ultimately selling the properties as single family housing and which led to the defaults.

Despite the presence of these mitigating factors, however, two considerations differ from the situation in *Darby*. First, Mr. Garvin originated the improper financing arrangement and, second, Mr. Garvin breached a fiduciary duty to the Department.
These considerations weigh heavily in favor of a period of debarment greater than the 18 month period imposed upon Mr. Darby.[15]

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[14]The Department's debarment regulations provide that the period of debarment for causes other than those related to a violation of the requirements concerning a drug-free workplace "generally should not exceed three years." *See* 24 CFR 24.320(a)(1). The regulations further provide that "[w]here circumstances warrant, a longer period of debarment may be imposed." *Id.* Examples of such circumstances include but are not limited to evidence of criminal intent, an intent to defraud the government, and acts which are wilful or egregious, combined with the lack of significant mitigating factors. Although the evidence presented in this proceeding supports a finding that Mr. Garvin's conduct was wilful, not only is there is no evidence of criminal intent, including an intent to defraud, but significant mitigating factors are also present.

[15]Two other mitigating factors delineated in the *Darby* Decision do not apply to Mr. Garvin because there is no record evidence upon which to base such findings. First, is the finding made that Mr. Darby "appeared to genuinely regret the situation in which he placed himself." *See Darby* Decision at 36. As support for that conclusion, I relied upon Mr. Darby's hearing testimony, during which he convincingly stated:

> this thing has been one of the most traumatic experiences in my life, it's ruined my reputation. It was in the paper, newspapers....Of greatest significance...is I can't do any more business with HUD.

Id., quoting Darby Tr. p. 842.

The conclusion that Mr. Darby felt regret was not predicated upon a finding that Mr. Darby believed he engaged in any misconduct. Rather, it was based upon the inference, drawn from his testimony, that after a suitable period of debarment, he would not engage in similar conduct in the future. Mr. Garvin, unlike Mr. Darby, did not testify concerning his reactions to the fall-out from his use of the Mid-South financing program. Thus, there is neither direct evidence or, as in *Darby*, evidence from which an inference can be drawn, upon which to conclude that Mr. Garvin regrets what has transpired and in all likelihood will not conduct his business dealings in a similar fashion in the future.

Second, in the *Darby* Decision, it was considered a mitigating factor that although Mr. Darby was able to "pull out" excess mortgage proceeds, his corporation *and* the syndicate covered substantial operating deficits for several years. *See Darby* Decision at 36. There is no record evidence which indicates that Mr. Garvin similarly covered operating deficits.

In rejecting the argument made by Mr. Darby that the government should be estopped form debarring him because of the doctrine of equitable estoppel, it was held in the *Darby* Decision that Mr. Darby's reliance on the representations made by HUD regarding the permissibility of the Mid-South program was unreasonable. *See Darby* Decision at 32-34. In so holding, reliance was placed on Mr. Darby's sophistication and experience in HUD's single family and multifamily programs. He therefore knew or should have known that the financing program violated the spirit and intent of the single family program, including the Rule of Seven and the minimum investment requirements. Thus, it was concluded that Mr. Darby could not hide behind the fact that Government employees approved the program when he, in the first instance, knew or should have known that it was improper. Rather than rely upon oral advice from the local office or from a staff employee at Headquarters on an issue of such complexity, Mr. Darby should have prepared a written proposal for review and received a written confirmation prepared by or on behalf of the Secretary or Assistant Secretary for Housing.[16]

For these same reasons, had Mr. Garvin acted as a reasonable and prudent businessman, he would have sought appropriate written approval prior to using the Mid-South financing program. However, what makes Mr. Garvin's nonfeasance in this regard more serious than that of Mr. Darby is the fact that Mr. Garvin was the person who conceived the program, who approached and dealt with the HUD Columbia Office concerning the program's propriety, and who first implemented the program. Mr. Darby's involvement did not begin until much

[16]The unreasonableness of Mr. Darby's reliance was underscored by regulatory changes concerning waivers of eligibility. Mr. Darby was not held responsible for a failure to utilize the regulation specifically designed for the consideration and approval of waivers since the regulation was not in effect when Mr. Garvin first approached the HUD Columbia Office with his financing program proposal. However, because Mr. Darby had submitted applications pursuant to the financing program at various times during the promulgation of the regulation, and because he knew or should have known of the rule's publication as a proposed and final rule, the fact that he failed to write to Headquarters to ascertain the ramifications of the new regulation on his use of the financing program tended to contradict his assertion of reasonable reliance.

later, and indeed, was based upon the fact that Mr. Garvin had already begun use of the program. Although Mr. Darby's inaction is not excusable, his failure to obtain prior written approval is somewhat tempered by his being the "follower" rather than the "leader". Mr. Garvin, as the "leader", was the person, despite the complicity of certain Departmental employees, upon whom primary responsibility for obtaining the necessary approval rested, and who, by shirking that responsibility, acted unreasonably and imprudently.

Mr. Garvin's actions were not only in contravention of the standard of care expected of a reasonable and prudent businessman, but constituted a breach of the fiduciary duty he owed to the Department. Mr. Garvin, as the president of Mid-South, was a principal of the HUD approved mortgagee which served as the lender in a significant number of the transactions at issue,[17] which processed nearly all the applications submitted pursuant to the financing plan, and whose employees served as the applicant/borrowers. By virtue of his position, Mr. Garvin was a fiduciary of HUD. *See In re Samuel T. Isaac and Assocs., Inc. and Samuel T. Isaac,* HUDBCA Nos. 80-452-M2, 80-485-D29 at 27-28 (Nov. 10, 1983), *quoting In re Ramsey Agan*, HUDBCA No. 83-773-D17 at 14 (April 21, 1983).

Based on his relationship of trust and confidence with HUD, Mr. Garvin was expected to adhere to all applicable statutes, regulations and program requirements in a responsible and prudent manner. As stated in *Isaac, supra,*

> As an HUD/FHA approved mortgagee, [STI, and Isaac] as its principal, should have an acute sense of responsibility to conduct themselves in general so as to satisfy those high standards, and so as not to reflect adversely in their general conduct upon the United States Government, or HUD in particular, with whose interests their interests are inextricably intertwined. This relationship of trust governs the general context in which the specific regulatory requirements imposed by HUD, and accepted by HUD/FHA mortgagees such as [STI], must be adhered to. *With the mantle of HUD's approval, such mortgagees are inevitably benefited in their business dealings with third parties who rely upon the implication of*

[17]Mid-South was the mortgage lender for 24 of the 36 transactions in which Mr. Garvin either in his own name or as a general partner acted as the applicant/borrower. (Garvin Gov't. Exs. H-11(e), H-12(e), H-13(e), H-14(e), H-15(e), H-16(e), H-17(e), H-18(e), H-19(e), H-20(e), H-21(e), H-22(e), H-23(e), H-24(e), H-25(e), H-27(e), H-29(e), H-30(e), H-31(e), H-32(e), H-33(e), H-34(e), H-35(e), H-36(e)). Mid-South was also the mortgage lender for a substantial number of the transactions at issue in the *Darby* Decision.

competence and trustworthiness which that mantle bestows. *Id.* (emphasis added).[18]

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[18]The duty owed by HUD approved mortgagees is set forth in the HUD Handbook routinely provided to HUD approved mortgagees entitled, "Mortgagees Handbook Application through Insurance (Single Family)". (HUD HB 4000.2 Rev-1 (April 1982), Darby Gov't. Ex. G-154; Darby Tr. pp. 68-71). That Handbook states:

> COMPLIANCE WITH LAWS AND REGULATIONS PERTAINING TO HUD. The Department of Housing and Urban Development's housing programs are created by Congress and are administered by the Department for the purpose of serving the housing consumer. *It is the Department's responsibility as well as the responsibility of HUD approved mortgagees to protect the public interest.* In order to protect the public interest, HUD's programs must be honest, free from fraud and other abuses.
>
> To accomplish this, HUD relies on the program participant's truthfulness and accuracy on every application certification and financial statement made. This reduces the paper work burden that would result if HUD required documented proof of each item....

(HUD HB 4000.2 Rev-1, Para. 1-6, Darby Gov't. Ex. G-154)(emphasis added).

Mr. Garvin's actions with regard to origination and implementation of the Mid-South financing plan constitute a failure to satisfy the obligations of a fiduciary. That failure is an additional factor which weighs in favor of imposition of a significant period of debarment greater than that imposed in the *Darby* Decision.

For the reasons set forth in the *Darby* Decision and based on the additional factors discussed above with specific regard to Mr. Garvin, the Department has established by preponderant evidence that Mr. Garvin lacks present responsibility. *See, e.g., Schlesinger v. Gates,* 249 F.2d 111 (D.C. Cir. 1957); *Stanko Packing Co. v. Bergland,* 489 F. Supp. 947 (D.D.C. 1980); *Roemer v. Hoffman,* 419 F. Supp. 130 (D.D.C. 1976).

*** * ***

As in the *Darby* Decision, a debarment for a meaningful period is necessary to deter Mr. Garvin and others[19] from acting similarly in the future. This period is necessary to ensure that upon its expiration, the public will be dealing with a presently responsible individual. For the reasons set forth above, the appropriate period of debarment for Mr. Garvin is greater than that which was imposed by this tribunal upon Mr. Darby. On the other hand, Mr. Garvin's actions, although wilful, are accompanied by mitigating circumstances, and a lack of criminal intent, which militate against a sanction of debarment in excess of the three year period a debarment "generally should not exceed...." *See* 24 CFR 24.320(a)(1). Accordingly, I find that Mr. Garvin should be debarred for a period of three years, beginning on June 19, 1989, the date on which the LDP was imposed. A debarment of three years is a serious sanction, commensurate with the seriousness of his acts. It is of sufficient duration to stress to Mr. Garvin the importance of protecting the public interest in any future dealings he might have with the Department, while not contravening the regulatory prohibition against sanctions which are punitive in nature. *See* 24 CFR 24.115(b).

Conclusion and Order

Under the particular circumstances presented during this proceeding, I

[19]For cases supporting the proposition that the sanction of debarment serves the goals of individual and general deterrence, *see, e.g., L.P. Steuart & Bro., Inc. v. Bowles,* 322 U.S. 398 (1944); *Janik Paving & Constr., Inc. v. Brock,* 828 F.2d 84 (2d Cir. 1987); *Copper Plumbing & Heating Co. v. Campbell,* 290 F.2d 368 (D.C. Cir. 1961).

conclude that the suspension of Lonnie Garvin, Jr. is based on adequate cause, is in the public interest, and should be sustained. Furthermore, upon consideration of the public interest and the entire record in this matter, I conclude that good cause exists to debar Lonnie Garvin, Jr. from further participation in primary covered transactions and lower tier covered transactions as either a participant or principal at HUD and throughout the Executive Branch of the Federal Government and from participating in procurement contracts with HUD for a period of three years, to run from June 19, 1989, the date of his Limited Denial of Participation, to and including June 19, 1992.

_____

William C. Cregar
Administrative Law Judge

Dated: January 11, 1991

CERTIFICATE OF SERVICE

I hereby certify that copies of this DECISION AND ORDER issued by WILLIAM C. CREGAR, Administrative Law Judge, in HUDALJ 90-1415-DB and HUDALJ 90-1506-DB, were sent to the following parties on this 11th day of January, 1991, in the manner indicated:

_____

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